IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

APPEAL FROM ORDER No 120 of 2000

For Approval and Signature:

Hon'ble MR.JUSTICE D.H.WAGHELA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

1 & 2 YES; 3 to 5 NO

PRECISION PRODUCTS

Versus

KERALA STATE POULTRY DEVELOPMENT CORPORATION LTD.

Appearance:

MR MIHIR H JOSHI for Petitioner

MR KEYUR GANDHI for NANAVATI ASSOCIATES for Res.1

CORAM : MR.JUSTICE D.H.WAGHELA

Date of decision: 04/07/2000

C.A.V. JUDGEMENT

1. ADMIT. Mr.Keyur Gandhi appearing on behalf of M/s. Nanavati Associates waives service of notice. Heard the learned counsel for the appellant and the respondent No.1. This appeal is preferred from the order below the Notice of Motion in Civil Suit No.2367 of 1998 whereby the prayer for interim injunction against invocation of bank guarantee is rejected. Earlier, an ad-interim injunction was granted on 6.5.1998 by the

Vacation Judge in the Civil Court and after the impugned order dated 25.2.2000, its effect was stayed for a period of four weeks to enable the appellants to approach the higher forum. Thereafter, the stay granted against its own order by the trial Court was extended and continued from time to time. By consent of the parties, the appeal is taken up for final hearing and disposed by this judgment.

2. The appellant firm (the original plaintiff) and the respondent (the original defendant No.1) have entered into a contract for design, procurement, fabrication, transportation erection and commission of a poultry feed mixing plant after the appellant's tender was accepted by the respondent. The period of completion of the work was stipulated to be six months from the date of the Letter of Intent which was dated 3.1.1996. Besides the other conditions, it was clearly stipulated in the contract that the time for completion of work was to be the essence of the contract. Pursuant to the stipulated terms of payments, but not strictly according to them, a payment of Rs.5,41,556 was made by the respondent by way of an advance against a bank guarantee of a like amount executed by the appellant. The rival pleadings and the documents placed on record indicate delay in the execution of the work due to the reasons attributed by the parties to each other. The basis and details of such allegations as are pleaded by the parties are elaborately discussed by the trial Court in the impugned order and are not required to be again discussed in detail for deciding the central issue arising in this case. It may be sufficient to state that a prima facie case was sought to be made out by the appellant on the basis of its allegation that a fraud was perpetrated by the respondent by entering into the contract without the necessary arrangement of funds and by delaying the completion of the project as per the contract by failing to arrange sufficient funds and, after committing the breach of the contract, by invoking the bank guarantee for recovering the amount which was already received and spent by the appellant in the execution of the contract. On the other hand, during the course of the delayed and incomplete execution of work under the contract, the respondent had warned the appellant by its letter despatched on 19.6.1996 that the considerable delay in implementation of the project could be viewed as a lapse in the fulfillment of the conditions of the contract. When the appellant had requested for despatch instructions and proper storage facilities for piecemeal despatch of the components of the project, the respondent had informed that piecemeal despatch of the materials was not

acceptable. At a meeting held on 8.10.1996 to review the implementation of the project where the appellant was represented by its Vice President, it was pointed out to him that piecemeal supply was not acceptable and the plant was required to be commissioned in accordance with the conditions. Thereafter, as per its letter dated 5.5.1997, the appellant sought despatch instructions for the equipments which were ready and requested for payments against them. Replying the said letter, the respondent stated that necessary finance would be arranged by it at the earliest and the entire lot of machinery would be lifted as soon as finance was made available to it. It has to be noted that, after this letter, in point of time, straightaway comes the letter dated 27.4.1998 invoking the bank guarantee. Thus, no clue as to the developments taking place during the period from June 1997 to April 1998 is to be found on the record.

3. The bank guarantee in question in favour of the respondent was initially issued on 16.3.1996 and extended upto 30.7.1998. The relevant paras of the bank guarantee read as under:

"We, State Bank of India, (hereinafter called the Bank) do hereby undertake to pay the purchaser an amount not exceeding Rs.5,41,556/- (Rupees Five Lacs Fourtyone thousand Five hundred Fiftysix only) against any loss/damage caused to or would be caused to or suffered by the purchaser by reason of any breach by the supplier of any of the terms and conditions contained in the Contract/ Purchase Order.

We, State Bank of India, do hereby undertake to pay the amounts due and payable under this guarantee without any demur merely on a demand from the purchaser stating that the amount claimed is due by way of loss or damage caused to or would be caused to or suffered by the purchaser by reasons of any breach by the supplier of any of the terms and conditions contained, in the contract/ purchase order or by reasons of the supplier's failure to perform the contract/purcahse order, any such demand made on the Bank shall be conclusive as regards the amount due and payable by the Bank under this guarantee shall be restricted to an amount not exceeding Rs.5,41,556/- (Rupees Five Lacs Fourtyone thousand Five hundred fiftysix only)."

4. On the facts as above, it is vehemently argued on behalf of the appellant that there are special equities in favour of the appellant in view of the breach of conditions and fraud committed by the respondent in respect of the primary contract, the issuance of bank guarantee as also in the matter of invocation of the bank guarantee after causing loss to the appellant. In support of his submissions, the appellant has relied upon the following observations made by the Hon'ble Supreme Court in U.P.COOPERATIVE FEDERATION LTD. v. SINGH CONSULTANTS AND ENGINEERS (P) LTD. [(1988) 1 SCC 174].

> "Whether it is a traditional letter of credit or a new device like performance bond or performance guarantee, the obligation of banks appears to be the same. If the documentary credits are irrevocable and independent, the banks must pay when demand is made. Since the bank pledges its own credit involving its reputation, it has no defence except in the case of fraud. The bank's obligations of course should not be extended to protect the unscrupulous seller, that is, the seller who is responsible for the fraud. But, the banker must be sure of his ground before declining to pay. The nature of the fraud that the courts talk about is fraud of an "egregious nature as to vitiate the entire underlying transaction". It is fraud of the beneficiary, not the fraud of somebody else."

5. It was submitted that the breach and violation of the conditions of the primary contract by the respondent amounted to a fraud on its part and applying the maxim ex turbi causa non oritur actio, it vitiated the invocation of the bank guarantee. It was also submitted that there are special equities in favour of the appellant and irretrievable injury was likely to be caused to it as it was a small scale industry who would be hard-hit by the further loss even as the respondent may not be able to make good the loss due to its financial difficulties in case the suit was ultimately decided in favour of the appellant. A case of fraud was also sought to be made out in respect of invocation of the bank guarantee on the basis of the conditions contained in it. It was pointed out from the paragraphs extracted hereinabove that causing of loss/ damage and sufferance of the same by the respondent by reason of any breach by the appellant of any of the terms and conditions of the contract was a condition precedent to invocation of the bank guarantee, and since such condition precedent was not fulfilled, the invocation of the bank guarantee was illegal. Developing

this argument, it was also submitted that the invocation was fraudulent inasmuch as the breach of the contract was committed by the respondent to its own knowledge and yet the bank guarantee was invoked as if the breach of the contract was committed by the appellant.

6. The learned counsel for the appellant relied upon the judgment of the Hon'ble Supreme Court in HINDUSTAN CONSTRUCTION CO. LTD. v. STATE OF BIHAR [(1999) 8 SCC 436] to submit that the bank guarantee was not unconditional or unequivocal in terms so as to allow the respondent an unfettered right to invoke the same. A picture of parallel facts was sought to be drawn and it was submitted that the terms of the bank guarantee were extremely material. In the facts of the case before the Supreme Court, the lapse was on the part of the defendants who were not possessed of sufficient funds for completion of the work and the allegation that the plaintiff itself abandoned the work did not, prima facie, appear to be correct and hence special equities were found to be in favour of the appellants. It has to be noted here that, in the facts of the present case, at best, a fairly arguable case of breach of contract can be made out on either side. Moreover, in HINDUSTAN CONSTRUCTION CO. LTD. (supra), the bank guarantee was containing a condition clearly referring to the original primary contract itself and the guarantee was supposed to be invoked only when that condition was specifically shown to have been violated. Whereas, the bank guarantee in the present case clearly stipulates that the bank undertook to pay the amounts due and payable under the guarantee without any demur and merely on demand from the respondent stating that the amount claimed is due by way of loss or damage caused or suffered by the purchaser by reason of breach by the supplier of any of the terms contained in the contract or by reason of the supplier's failure to perform the contract/ purchase order and such demand made by the bank is to be conclusive as regards the amounts due and payable by the bank. It has been fairly conceded that, under the independent contract of bank guarantee, the bank cannot be allowed to inquire or investigate the statement made by the beneficiary.

7. In the facts of this case, the breach of contract is alleged on both sides and as observed in the impugned order, each and every aspect pleaded by the appellant required investigation and examination after the case was put to trial. However, the fact remains that the allegations of fraud are sought to be made out of the alleged breach of the primary contract between the parties and not in respect of the contract of bank

guarantee, which is a contract between the respondent and the bank. Even the allegations of fraud in the matter of invocation of the bank guarantee are also based on the allegation of the loss or damage to either party arising out of the breach of the primary contract between the parties. The stipulation in the first of the clauses of the bank guarantee quoted above has to be read as qualified by the next stipulation. Therefore, the factum of any loss or damage caused or suffered by the respondent by reason of any breach by the appellant of any of the terms and conditions contained in the contract cannot be questioned or inquired into by the bank as the demand made on the bank by way of invocation is stipulated to be conclusive as regards the amount due and payable by the bank. The argument that while invoking the bank guarantee the respondent was conscious of the fact that breach of the primary contract was committed by him and no loss or damage was caused to him cannot be accepted, because it is the contentious issue which is yet to be decided by the Court. In this view of the matter, the contention that the respondent was committing a fraud in the matter of invocation of the bank guarantee has no substance.

8. The Hon'ble Supreme Court has, in DWARIKESH SUGAR INDUSTRIES LTD. v. PREM HEAVY ENGINEERING WORKS PVT. LTD. [(1997) 6 SCC 450], clearly laid down the guidelines in the matter of granting injunction to restrain realization of bank guarantee and the same can be summarised as under:

(i) Court should be slow in granting injunction to restrain realization of bank guarantee;

(ii) The right to recover the guaranteed amount is not to be affected or suspended by reason of any dispute which can be raised or which may be pending before courts, tribunals or arbitrator;

(iii) If the guarantor had no right to know the reasons of or to investigate the merits of the demand or to question or to challenge the demand, or to know any facts affecting the demand, it may not be open to the bank to require the proof of liability before paying the guaranteed amount.

(iv) In absence of established fraud, [and not

a mere allegation of fraud made only in the injunction application] the court ought not to grant any injunction against encashment of bank guarantee.

(v) Besides the fraud in connection with the bank guarantee which would vitiate the very foundation of it, there could be a second possible exception where encashment of an unconditional bank guarantee would result in irretrievable harm or injustice to one of the parties. The harm or injustice must be of such exceptional and irretrievable nature as would override the terms of the guarantee and the adverse effect of such injunction on commercial dealings.

9. The learned counsel for the appellant has also relied upon a judgment of this Court in PREM CONDUCTORS PVT. LTD. v. STATE BANK OF INDIA [1999 (1) GLR 118] wherein the defendant, by its own conduct, placed the plaintiff in a position where it could not perform its part of the contract. On such facts, it is held that to permit invocation and realisation of the bank guarantee would tantamount to permitting a party to take advantage of its own wrong even if such wrong or lapse was inadvertent or beyond his control. It was submitted that, in the instant case also, such exceptional circumstances existed which justified judicial interdiction. This judgment cited on behalf of the appellant can easily be distinguished on facts insofar as, in the instant case, the terms of the contract in respect of the advance payments to be made by the respondent were wholly independent of the time-frame within which the plant was to be fabricated, supplied and erected. Therefore, prima facie, it cannot be said that the failure on the part of the appellant in performing its part of the contract was a direct consequence of the failure on the part of the respondent in making temporary advance payments.

10. The learned counsel appearing for the respondent has relied upon (1996) 5 SCC 450 (ANSAL ENGINEERING PROJECTS LTD. v. TEHRI HYDRO DEVELOPMENT CORPORATION LTD.) in support of his submission that the beneficiary cannot be restrained from encashing the bank guarantee even if the dispute between the beneficiary and the person at whose instance the bank guarantee was given by the bank, had arisen in performance of the contract, or execution of the works undertaken in furtherance thereof. It was

further submitted that any payment by the bank would obviously be subject to the final decision of the Court. At the stage of invocation of the bank guarantee, the need for final adjudication and decision on the amount given by the appellant is not called for and would run contrary to the terms of the special contract entered into in the form of the bank guarantee. Relying upon the judgment in SREE JAIN SWETAMBAR TERAPANTHI VID v. PHUNDAN SINGH (AIR 1999 SC 2322), it is also submitted that the impugned order of the trial Court cannot be set aside unless the trial Court is found to have gone wrong in recording prima facie satisfaction and unless the material on record was leading to a contrary finding. The judgment of this Court in VIJAYSINH AMARSINH & CO. v. HINDUSTAN ZINC LTD. [1992 (1) GLR 639] is also relied upon on behalf of the respondent to point out that if the suit were to be brought by the bank, the Court would not have granted injunction as the bank was bound by the terms of the contract and what could not be done directly cannot be achieved indirectly in a suit brought by the appellant.

11. In the facts of the present case, the documents on record suggest that, for whatever reasons, not a single component of the project was despatched by the appellant and there was no question of completion or commissioning of the project. Even as the appellant was urgently awaiting destpach instructions and further payments and the dispute regarding acceptability of piecemeal despatches was going on, the time-limit for completion of the project had since long expired on 3.7.1996. The condition of the contract for the project does not contain any stipulation for delaying execution of work against delay in the receipt of payments by the appellant. Therefore, prima facie, the allegations of delay or difficulties of the respondent in arranging funds and giving despatch instructions are unduly brought in to justify the delay and failure at the appellant's end. Such tentative conclusion is inescapable in view of the fact that the appellant has not even once conveyed to the respondent that all the components and each of the items were ready for despatch. On the contrary, the parties appear to have ceased to communicate after the letter dated 19.5.1997 sent to the appellant by the Finance Manager of the respondent. Thus, if, in fact, the project was abandoned due to time overruns, the respondent would be justified in recovering the payments made by way of advance by invoking the bank guarantee. And, prima facie, the appellant does not have any special equities in its favour. As against the apprehension of the appellant about the poor financial condition of the

respondent and the doubts about the recovery of any amount if such eventuality arises, the learned counsel for the respondent has, on instructions, stated that the respondent undertakes to meet any claim arising from the invocation of the bank guarantee.

12. It has also to be noted here that, in the instant case, the bank guarantee in question was meant to cover the grant of advance and against the loss or damage suffered due to breach of any condition of the contract. Where the whole project is wound up or abandoned due to delays apparently occasioned by bickering over despatch instructions and piecemeal supplies, it cannot be held that a party should not be allowed to encash the bank guarantee to recover the advance paid; even though ultimately either party might be found to be responsible for the breach of the primary contract. In other words, unless and until such breach of the contract is proved, it cannot be said that the respondent had, to its own knowledge, not suffered but caused a loss and its invocation of the bank guarantee to recover the amount paid as advance was mala fide or fraudulent. In this context, it has to be borne in mind that the bank guarantee is an independent agreement between the bank and the beneficiary and the undertaking contained therein has to be ordinarily enforced except where a strong case of fraud or irretrievable loss or injury is made out in the matter of its invocation. The appellant has failed to make out such a strong case and there is no reason to interfere with the tentative conclusions as regards prima facie case and balance of convenience to which the trial Court has reached in the impugned order.

13. In the result, in the circumstances and for the reasons stated hereinabove, the appeal is dismissed with no order as to costs.

14. The learned counsel for the appellant has requested that in case of the appeal being dismissed, the stay operating in favour of the appellant may be continued for a further period of four weeks for the purpose of allowing the appellant to approach the higher forum. Accordingly, this prayer is granted and the stay order granted by the trial court which was operative till date, shall continue upto 29.7.2000.

Sd/-

(KMG Thilake)

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